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As you requested, here is the CCA answering the questions that sent our office a few weeks back. If you have any further questions please do not hesitate to contact me at .

ISSUES

1. Must the suitable for occupancy requirement of section 42(i)(3)(B) be determined on a unit-by-unit basis, or can the condition of the exterior components of the building (e.g., wall, roof, etc.) be so poor as to lead to a determination that all the units in a building are not suitable for occupancy?
2. Explain the relationship between HUD's uniform physical condition standards (UPCS) and the "local health, safety and buildings codes" as described in Treas. Reg. section 1.42-5(d).

LAW AND ANALYSIS

Section 42(i)(3)(B)(i) of the Internal Revenue Code (Code) provides that a low-income unit (as defined by section 42(i)(3)(A)) shall not be treated as a low-income unit unless the unit is suitable for occupancy and used other than on a transient basis. Section 42(i)(3)(B)(ii) of the Code provides that the suitability of a unit for occupancy shall be determined under regulations prescribed by the Secretary taking into account local health, safety, and building codes.

Treasury regulation section 1.42-5 provides compliance monitoring responsibilities required of a State or local housing credit agency (Agency). Under section 1.42-5(d)(2), an Agency for on-site inspections of buildings and low-income units must review any local health, safety, or building code violations reports or notices retained by the owner and must determine "(i) whether the buildings and units are suitable for occupancy, taking into account local health, safety, and building codes (or other habitability standards); or (ii) whether the buildings and units satisfy . . . the uniform physical condition standards for public housing established by HUD (24 CFR 5.703). The HUD physical conditions standards do not supersede or preempt local health, safety, and building codes. A low-income housing project under section 42 must continue to satisfy these codes and, if the Agency becomes aware of any violation of these codes, the

Agency must report the violation to the Service. However, provided the Agency determines by inspection that the HUD standards are met, the Agency is not required ... to determine by inspection whether the project meets local health, safety, and building codes.”

CONCLUSIONS

1. The suitable for occupancy requirement of section 42(i)(3)(B) does not have to be determined on a unit-by-unit basis if the facts exist that the condition of the exterior components of the building (e.g., wall, roof, etc.) are so poor as to lead to a factual determination that all the units in a building are not suitable for occupancy. For example, if an earthquake created large fissures in the foundation and exterior walls of a building than the building could be determined not suitable for occupancy for safety reasons without having to check each unit.
2. Under Treas. Reg. section 1.42-5(d)(2), an Agency may use the HUD uniform physical condition standard to perform an on-site inspection to satisfy the Agency’s inspection responsibility. A violation of the HUD physical condition standard alone is sufficient for a violation of § 42(i)(3)(B). However, a taxpayer, in response to the IRS finding a violation, may raise an affirmative defense by proving that local health, safety, or building codes address the specific point in question, and after application of the facts, local law reaches a taxpayer favorable result where as the HUD standard does not reach a taxpayer favorable result. Under these circumstances, the local law would control as respects the violation itself.